12. (2 points)

The following information is provided for two insurance companies:

	Company A	Company B
2012 Written Premium	\$7,800,000	\$15,000,000
% Growth in Premium in 2012	15%	5%
Years since inception	7	12
Number of jurisdictions	2	10

a. (1 point)

Identify and briefly describe two risks that could lead to the wind-up of an insurance company.

b. (1 point)

Using the information above, discuss which company would be considered a higher risk for wind-up.

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Question 12

Answer key:

a) Insolvency risk - when assets become insufficient for an insurance company to meet its contractual and other financial obligations.

Liquidity risk - when it has sufficient assets to cover its obligations but there is a high level of risk those assets could disappear.

Note: need to accept wide range of answers for including insurance risk (reserving, pricing, catastrophe), market risk, operational risk, etc. – all the types of risk now spoken about in ORSA, economic capital modeling, ERM – they are all valid answers

b) Company A is more likely to wind up

3 of the following reasons (points for explanation only not identification since these are given in the problem)

a. Size – Company A is smaller and could have less expertise and resources in management and also has less diversification benefits.

b. Growth – Company A's 2012 growth was very aggressive. Rapid growth indicates aggressive expansion growth strategies where companies might be expanding in areas where underwriting experience is lacking

c. Age – Company A is relatively young compared to Company B. New entrants face strong competition from companies already entrenched in the market and may have inexperienced management teams

d. Number of jurisdictions – Company A operates in fewer jurisdictions so it would benefit less from diversification. Number of jurisdictions is not explicitly listed in the syllabus material but would deserve points if candidates can identify

Actual candidate answer for full marks:

a.

Insolvency Risk: when a company can no longer meet all it's financial obligations

Liquidity Risk: when a company assets pose a liquidity threat and may not be able to be sold if needed to cover it's obligations

b.

Company A is the higher wind-up risk:

- It is smaller (in terms of written premium)
- It is growing faster (typically seen in troubled firms)
- It Is younger (less established and experienced)
- It is less diversified (fewer jurisdictions, thus higher risk of a significant)

Examiner's report:

This is a fundamental question. There were several possible answers accepted. For part B. answers are easily deduced from the comparative table provided.

Question 13

Answer key:

a) b)

- Once a commodity is selected, all production of that commodity must be insured. This helps keep premiums down by avoiding insurance of only the most risky production.
- For crops, producers select their desired level of coverage ranging from 50 to 90% of their normal or expected yield. This deductible ensures that producers are always responsible for the first loss.
- Producers must buy insurance either before a commodity is planted or before any damage is possible.

c) Three of the following

- Minimizing countervail risk
- Focusing on the management of risks related to the stability of the entire farm entity,
- Encouraging the use of risk management practices and contributing to the use and development of private sector risk management tools (separate point from #2)
- Being relatively simple to administer and transparent for participants
- Minimizing the capitalization of program benefits into farm asset values

Actual candidate answer for full marks:

a.

1. Insurance must be purchased before planting or before damage possible
2. Once elected, all production of a commodity must be insurance
3. Usually a deductible and coinsurance apply which means that insured is responsible for the first loss and a portion of insured losses

b.

1. Avoid insurance being purchased because it is already needed
2. Avoid insurance only on part of the farm that is known to be problematic
3. Encourage loss control by ensuring that insured is responsible for the first losses and portion of insured losses

c.

1. Minimize distortion of the producer`s production and marketing decisions
2. Encourage risk management practices and promote development of risk management tools
3. Simplify administration process and promote transparency

Examiner's report:

Part A and B are quite intuitive and most candidates could provide several examples of provisions to control moral hazard. Part C is less intuitive and involves memorizing a list of principles. Most candidates did not do well on Part C.